

Internal Revenue Service

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Washington, DC 20224

Third Party Communication: None

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PLR-124060-06

Date: September 5, 2006

LEGEND

X =

Trust 1 =

Trust 2 =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

State =

Dear

This responds to a letter dated April 26, 2006, submitted on behalf of X, requesting a ruling under § 1362(f) of the Internal Revenue Code.

FACTS

According to the information submitted, X was incorporated on Date 1 under the laws of State. X elected to be treated as an S corporation effective Date 2. On Date 3, stock in A was transferred to Trust 1. X represents that Trust 1 was qualified to elect to be a qualified subchapter S trust (QSST), within the meaning of § 1361(d)(3), and that the income beneficiary of Trust 1 intended to file an election under § 1362(d)(2) to treat Trust 1 as a QSST. However, the appropriate election inadvertently was not filed. As a result of the failure to file the QSST election for Trust 1, X's S corporation election terminated on Date 3.

Stock in X was transferred to Trust 2 on Date 4. X represents that Trust 2 was qualified to elect to be a QSST, within the meaning of § 1361(d)(3). On Date 5, the income beneficiary of Trust 2 filed a timely QSST election for Trust 2. However, because of the termination of X's S corporation election on Date 3, the QSST election for Trust 2 was ineffective.

X represents that the failure to file the QSST election for Trust 1 was not motivated by tax avoidance or retroactive tax planning. X further represents that X and all of its shareholders have consistently treated X as an S corporation at all times since Date 2, and that X's shareholders (including the trusts) have consistently included their distributive shares of X's income on their respective federal income tax returns. Finally, X and its shareholders agree to make any adjustments required by the Secretary consistent with the treatment of X as an S corporation.

LAW AND ANALYSIS

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1) defines a "small business corporation" as a domestic corporation that is not an ineligible corporation and that does not (A) have more than 100 shareholders, (B) have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than one class of stock.

Section 1361(d)(1) provides that a QSST whose beneficiary makes an election under § 1362(d)(2) will be treated as a trust described in § 1361(c)(2)(A)(i), and the QSST's beneficiary will be treated as the owner (for purposes of § 678(a)) of that portion of the QSST's S corporation stock to which the election under § 1362(d)(2) applies. Under § 1361(d)(2)(A), a beneficiary of a QSST may elect to have § 1361(d) apply. Under § 1361(d)(2)(D), this election will be effective up to 15 days and two months before the date of the election.

Section 1361(d)(3) defines a QSST as a trust (A) the terms of which require that (i) during the life of the current income beneficiary, there shall be only one income beneficiary of the trust; (ii) any corpus distributed during the life of the current income beneficiary may be distributed only to such beneficiary; (iii) the income interest of the current beneficiary in the trust shall terminate on the earlier of the beneficiary's death or the termination of the trust; and (iv) upon the termination of the trust during the life of the current income beneficiary, the trust shall distribute all of its assets to that beneficiary; and (B) all of the income (with the meaning of § 643(b)) of which is distributed (or required to be distributed) currently to one individual who is a citizen or resident of the United States.

Section 1362(f) provides that if (1) an election under § 1362(a), § 1361(b)(3)(B)(ii), or § 1361(c)(1)(A)(ii) by any corporation (A) was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361(b) or to obtain shareholder consents, or (B) was terminated under § 1362(d)(2) or (3), § 1361(b)(3)(C), or § 1361(c)(1)(D)(iii), (2) the Secretary determines that the circumstances resulting in the ineffectiveness or termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in the ineffectiveness or termination, steps were taken (A) so that the corporation is a small business corporation or a qualified subchapter S subsidiary, as the case may be, or (B) to acquire the required shareholder consents, and (4) the corporation and each person who was a shareholder of the corporation at any time during the period specified pursuant to § 1362(f), agrees to make any adjustments (consistent with the treatment of the corporation as an S corporation or a qualified subchapter S subsidiary, as the case may be) as may be required by the Secretary with respect to the period, then, notwithstanding the circumstances resulting in the ineffectiveness or termination, the corporation will be treated as an S corporation or a qualified subchapter S subsidiary, as the case may be, during the period specified by the Secretary.

CONCLUSION

Based solely on the information submitted and the representations made, we conclude that X's S election terminated on Date 3 because a QSST election was not filed for Trust 1. In addition, we conclude that the termination was inadvertent within the meaning of § 1362(f). Therefore, X will be treated as continuing to be an S corporation from Date 3, and thereafter, provided that the income beneficiaries of Trust 1 and Trust 2 file QSST elections with the appropriate service center, effective Date 3 for Trust 1 and Date 4 for Trust 2, within 60 days of the date of this letter. A copy of this letter should be attached to the QSST elections.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed concerning whether X is otherwise

eligible to be treated as an S corporation, or whether Trust 1 and Trust 2 are eligible to be treated as QSSTs.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

Dianna K. Miosi
Chief, Branch 1
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)

Copy of this letter

Copy of this letter for § 6110 purposes